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In the Supreme Court of the United States

OCTOBER TERM, 1982

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

In Section 210(a) of the Public Utility Regulatory Policies Act of 1978 (PURPA), Congress directed the Federal Energy Regulatory Commission to issue rules requiring electric utilities to purchase power from qualifying cogenerator and small power production facilities and to provide such facilities with back-up power. The questions presented are:

1. Whether Section 210(e)(3)(B) of PURPA requires the Commission to provide case-by-case evidentiary adjudications before it may compel utilities to interconnect with qualifying facilities for the purpose of effectuating the purchases and sales mandated by the Commission's rules under Section 210(a).

2. Whether the Commission's rule establishing the rate at which utilities must offer to purchase power from qualifying facilities (*i.e.*, the "full avoided cost" rule) satisfies the statutory directive that the Commission adopt a rule reasonable to electric consumers, in the public interest and non-discriminatory in its effects on qualifying facilities.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Federal Energy Regulatory Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B–1 to B–34)[1] is reported at 675 F.2d 1226. The opinions accompanying the orders denying rehearing and rehearing en banc (Pet. App. B–202 to B–208) are reported at 675 F.2d 1246. The orders of the Commission (Pet. App. B–38 to B–119, B–120 to B–174 and B–175 to B–199) are reported at 45 Fed. Reg. 12214, 17959 and 33958, respectively.

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[1] "Pet. App." refers to the petition for a writ of certiorari in No. 82–34.

JURISDICTION

The judgment of the court of appeals (Pet. App. B–200 to B–201) was entered on January 22, 1982. A petition for rehearing was denied on April 9, 1982 (Pet. App. B–202 to B–208). Chief Justice Burger extended the time in which to file a petition for a writ of certiorari to and including August 7, 1982. On July 29, 1982 Justice Brennan granted an additional extention of time to and including August 14, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth at Pet. App. A–7 to A–24.

STATEMENT

A. THE STATUTORY BACKGROUND

1. This case involves a judicial challenge to certain regulations promulgated by the Federal Energy Regulatory Commission pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA), Pub. L. No. 95–617, 92 Stat. 3144 (16 U.S.C. (Supp. IV) 824a–3). The constitutional validity of the Act, including Section 210, was recently upheld by this Court in *FERC* v. *Mississippi*, No. 80–1749 (June 1, 1982). As the Court noted in that case, PURPA was enacted as part of a comprehensive legislative package in an effort to "lessen the country's dependence on foreign oil, to avoid repetition of the shortage of natural gas that had been experienced in 1977, and to control consumer costs." Slip op. 2. Section 210 serves this objective by

encouraging the development of cogeneration and small power production facilities.[2] It was Congress' belief that "increased use of these sources of energy would reduce the demand for traditional fossil fuels." Slip op. 6.

Congress found, however, that two longstanding problems had impeded the development of these alternative sources of electric energy: "(1) traditional electric utilities were reluctant to purchase power from, and to sell power to, the non-traditional [generating] facilities; and (2) the regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the nontraditional facilities and thus discouraged their development." Slip op. 6–7 (footnotes omitted).

In order to overcome the first problem, Congress, in Section 210(a) of PURPA, 16 U.S.C. (Supp. IV) 824a–3(a), directed the Commission, within one year of PURPA's enactment, to prescribe "such rules as it determines necessary to encourage cogeneration and small power production," including rules requiring electric utilities to offer to purchase electricity from, and sell electricity to, qualifying cogeneration and small power production facilities. Section 210(f) of PURPA, 16 U.S.C. (Supp. IV) 824a–3(f), requires each state regulatory authority and nonregulated utility to implement the Commission's rules.

Section 210(b) of PURPA, 16 U.S.C. (Supp. IV) 824a–3(b), provides that the Commission's rules requiring the purchase by a utility of electricity from a qualifying facility shall insure that the rates for such

[2] The statute defines a "cogeneration facility" as a facility that produces both electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. (Supp. IV) 796(18)(A). A "small power production facility" is a facility that has a production capacity of not more than 80 megawatts and uses biomass, waste, or renewable resources (such as wind, water, or solar energy) to produce electric power. 16 U.S.C. (Supp. IV) 796(17)(A).

purchase are: (1) just and reasonable to the utility's customers and in the public interest; and (2) nondiscriminatory with respect to the qualifying cogeneration or small power production facility. In addition, Section 210(b) provides that no rule prescribed by the Commission "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy."[3]

The second barrier that had inhibited the development of nontraditional energy sources was removed by Section 210(e)(1) of PURPA, 16 U.S.C. (Supp. IV) 824a–3(e)(1). That section authorizes the Commission to exempt qualifying facilities from federal and state regulation as public utilities if it determines that such exemption is necessary to encourage cogeneration and small power production.

2. In addition to the above provisions, Sections 210 and 212 of the Federal Power Act (FPA or Power Act), 16 U.S.C. (Supp. IV) 824i and 824k, are also pertinent to this case. Those sections, which were added to the Power Act by Sections 202 and 204(a) of PURPA (92 Stat. 3135 and 3138), empower the Commission, after meeting substantive and procedural requirements, to order a qualifying facility or any electric utility[4] to: (1) establish an interconnection; (2) sell or exchange power; and (3) increase transmission facilities. An "intercon-

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[3] In Section 210(d), 16 U.S.C. (Supp. IV) 824a–3(d), Congress defined the term "incremental cost of alternative electric energy" as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source."

[4] "Electric utility" is defined as "any person or State agency which sells electricity." 16 U.S.C. (Supp. IV) 796 (22). The term thus includes entities that previously had been outside the Commission's regulatory province, such as state agencies (16 U.S.C. 824(f)) and utilities that do not sell electricity in interstate commerce (16 U.S.C. 824(e)).

nection" is a physical connection that permits electricity to flow from one entity to another (Pet. App. B–20).

In Section 210(e)(3) of PURPA, Congress provided that:

> No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—
>
> * * * * *
>
> (B) the provisions of section 210 * * * or 212 of the Federal Power Act * * * or the necessary authorities for enforcement of any such provision under the Federal Power Act * * *.

B. The Rules Adopted By The Commission

Following extensive rulemaking proceedings, the Commission issued Order No. 69 (Pet. App. B–38 to B–119), governing transactions between utilities and qualifying facilities. That order embodies a number of regulations designed to accomplish the statutory goal of encouraging the development of cogeneration and small power production.[5] Two of those regulations are at issue here.

1. The first regulation, codified at 18 C.F.R. 292.303, requires electric utilities to: (1) purchase any energy and capacity made available from a qualifying facility; (2) sell energy and capacity to any qualifying facility at the latter's request; and (3) make the interconnections necessary to accomplish such transactions at the qualifying facility's expense. While the Commission recognized that Section 210(a) of PURPA refers in terms only to purchases and sales and not to interconnections,

[5] In Order No. 70 (Pet. App. B–120 to B–174), the Commission established criteria for determining when a cogeneration or small power production facility shall be considered a qualifying facility within the meaning of PURPA. The regulations included in Order No. 70 were upheld by the court of appeals below and are not at issue.

it concluded that Congress' directive to the Commission to prescribe rules necessary to encourage cogeneration and small power production provided sufficient authority to require the interconnections necessary to accomplish these purchases and sales (Pet. App. B–58 to B–59).

The Commission rejected the argument that under Section 210(e)(3)(B) of PURPA it must afford an evidentiary hearing and make the determinations required by Sections 210 and 212 of the Power Act whenever a qualifying facility seeks to interconnect for the purpose of effectuating the transactions mandated by Section 210(a) of PURPA (Pet. App. B–59 to B–60). The Commission reasoned that the plain language of the statute compelled no such result and that, moreover, requiring qualifying facilities to utilize FPA Sections 210 and 212 as the exclusive means of obtaining interconnection would frustrate achievement of a basic purpose of Section 210(a) of PURPA—to provide a market for the electricity generated by cogenerators and small power producers.

On rehearing, the Commission adhered to its earlier determination (Pet. App. B–179 to B–182). It noted that Section 210(e) of PURPA empowers the Commission generally to exempt qualifying facilities from regulation as public utilities under the Power Act—except, by virtue of subsection (e)(3)(B), from the authority newly granted in Sections 210 and 212 of the Power Act. That authority, the Commission noted, allows it to "impose [certain] obligations on qualifying facilities, including requiring the physical connection of the qualifying facility with the applicant, the sale or exchange [of] electric energy, or an increase in transmission capacity * * *" (Pet. App. B–181). It is from these obligations, which are unrelated to the concerns underlying Section

210(a) of PURPA, that "section 210(e)(3)(B) provides that the qualifying facilities may not be exempted" (Pet. App. B–181).

2. In the second regulation at issue here, the Commission provided that the rate for purchase from a new qualifying facility must be equal to the utility's full "avoided costs." 18 C.F.R. 292.304(b)(2). The term "avoided costs" is defined in 18 C.F.R. 292.101(b)(6), and is essentially the equivalent of the statutory term "incremental cost of alternative electric energy." See note 3, *supra*.

The Commission considered, but rejected a fixed-percentage-of-avoided-cost-rule, finding that such a rule would cause a qualifying facility to cease production of energy if its costs exceed that fixed percentage price (Pet. App. B–66). The Commission explained that "[i]f this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs" (*ibid.*).

In addition, the Commission noted that "under the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates they would have paid had the utility not purchased energy and capacity from the qualifying facility" (Pet. App. B–65). Moreover, as the Commission pointed out (*ibid.*):

> Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy.

The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reduction will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

C. The Decision of the Court of Appeals

On review, the court of appeals vacated the Commission's rules with respect to interconnection and full avoided cost (Pet. App. B–1 to B–34).

1. The court invalidated the rule authorizing interconnections between qualifying facilities and utilities, concluding that Section 210(e)(3)(B) of PURPA requires the Commission to afford evidentiary hearings and make findings under Sections 210 and 212 of the Federal Power Act before ordering any interconnections necessary to accomplish the purchases and sales required under Section 210(a) of PURPA (Pet. App. B–20 to B–25). The court interpreted the Commission's rule as effectively exempting qualifying facilities from these procedures, a result that the court believed was contrary to statutory requirements.

The court characterized the Commission's interpretation of Section 210(e)(3)(B) of PURPA "as protecting cogenerators who are *targets* of *other* parties seeking interconnection, and not extended to situations where the cogenerator is an *applicant* for an interconnection itself," and said that it was "an interesting and not inherently implausible suggestion" (Pet. App. B–24; emphasis in original). But the court believed that this interpretation was not supported by the language or legislative history of the statute (*id.* at B–25). Finally, the court expressed the view that any undue burden its interpretation placed on qualifying facilities could be

avoided by adopting "streamlined procedures," but that, if even those were too burdensome, "the necessary amendment must come from Congress" (*id.* at B–23).

2. In vacating the Commission's "full avoided cost" rule, the court viewed the issue as whether the rule "is consistent with the statutory mandate that the rates set by the Commission must, in addition to not discriminating against cogenerators, also be 'just and reasonable to the electric consumer of the electric utility' and 'in the public interest'" (Pet. App. B–9). The court held that the Commission did not adequately explain its adoption of the full avoided cost standard.

More particularly, the Court first determined that the Commission had failed "to demonstrate the factual basis" for its determination that something less than the full avoided cost would result in "'insignificant'" rate reductions for utility customers (Pet. App. B–11). Second, the court stated that "the Commission's assertion that a split-the-savings [6] rule would require utilities-type regulation in contravention of the purpose of PURPA is inadequate" because there are other alternatives that the Commission could have adopted instead of full avoided cost, such as setting rates at a percentage of avoided cost, that also might avoid the traditional utilities-style rate making that Congress wanted to avoid (*ibid.*). Finally, the court asserted that the Commission's determination "that the bare, unquantified possibility that a rule permitting rates at less than full cost *might* be insufficient to encourage the last kilowatt hour of cogeneration" is "inconsistent with the clear intent of section 210(b), which seeks to strike a balance among the interests of congenerators, 'electric

[6] As the court explained, under a "split-the-savings" approach, "the price is set somewhere between the incremental cost of the buying utility and the incremental cost of the selling utility, so that each benefits by the transaction" (Pet. App. B–13 n.37).

consumers of electric utilit[ies]' and the 'public interest'" (Pet. App. B–12; emphasis in original). The court stated that the Commission "should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration" (*ibid.*).

3. The Commission's petition for rehearing was denied by the panel (Pet. App. B–202 to B–204). A majority of the whole court did not participate in considering the suggestion for rehearing en banc and that suggestion was also denied (Pet. App. B–205 to B–208). The only two judges (apart from the panel members) to consider the suggestion voted to rehear the case en banc "because of the importance of the issues to major new energy programs of cogeneration and small power production and because of serious doubts over the panel's resolution of those issues" (*id.* at B–206). They noted that "[t]he panel has interpreted an incredibly complex and ambiguous interlace of statutory sections to require a fullscale evidentiary hearing prior to any interconnections for the sale or purchase of cogenerated power" (*id.* at B–207 and B–208). In the dissenters' view, the Commission's interpretation, which the panel rejected, "is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration" (*id.* at B–208). As to the full avoided cost issue, the dissenters expressed the view that the Commission appears to have acted reasonably in weighing the statutory interests and adopting "a rate that would encourage cogeneration without raising rates to consumers" (*id.* at B–207).

REASONS FOR GRANTING THE PETITION

Last Term, in upholding the constitutionality of Section 210 of PURPA, this Court observed that "Congress * * * determined that the development of

cogeneration and small power production facilities would conserve energy." *FERC* v. *Mississippi*, *supra*, slip op. 13. The decision below substantially thwarts that congressional purpose by overturning the two Commission rules at issue in this case.

First, in construing the intricate statutory framework as permitting interconnection between qualifying facilities and utilities only after affording adjudicatory proceedings, the court below has, in the words of the judges dissenting from the denial of rehearing en banc, "erect[ed] a formidable, perhaps insurmountable, roadblock to a major energy program" (Pet. App. B–208). The court achieved this unfortunate result despite the fact that the alternative, contemporaneous interpretation by the agency charged with administering and enforcing the statute is "plausible" and "appears to be more closely in line with Congress' expressed desire to encourage cogeneration" (*ibid.*).

Second, the panel's decision to vacate the "full avoided cost" rule on the ground that the Commission failed to explain "its rationale and process of consideration" (Pet. App. B–9) indicates that the court below misconceived the nature and purpose of that rule and the underlying statutory mandate. Moreover, in reaching this determination the court sought to interpose its own policy choices, thus significantly intruding into the domain exclusively reserved for agency decision-making.

1. It is common ground that the central purpose of Section 210 of PURPA is to encourage production of electricity by qualifying cogeneration and small power production facilities. To that end, Congress, in Section 210(a), directed the Commission to issue rules requiring electric utilities to purchase power from these non-traditional facilities and to provide back-up power at nondiscriminatory rates. Notwithstanding the fact that

interconnection is an integral, indeed essential, condition to achievement of the express purpose of Section 210(a) of PURPA, the court below held that whenever a qualifying facility seeks to interconnect with an unwilling utility in order to engage in cogeneration or small power production, it will be required to undergo an evidentiary adjudication to determine if the interconnection is justified under the substantive standards of Sections 210 and 212 of the Federal Power Act. This view completely overlooks the background and purpose of FPA Sections 210 and 212 and is based on a misreading of Section 210(e)(3)(B) of PURPA. The result, moreover, defeats the basic goal of Section 210 of PURPA. Accordingly, we submit that the court of appeals clearly erred in rejecting the Commission's reasonable construction of this complex statutory scheme.

a. Prior to the enactment of Section 210 of the Federal Power Act in 1978, the Commission's authority to order interconnections was limited, under Section 202 of that Act, 16 U.S.C. 824a, to utilities over which it had regulatory jurisdiction and, except for emergencies, to situations in which a "person engaged in the * * * sale of electric energy" (16 U.S.C. 824a(b)) applied for an order directing a jurisdictional utility to interconnect. The legislative background of FPA Section 210 shows that some intrastate utilities had in the past refused to make interconnections with other systems because, had they done so, they would have become part of an interstate system and thereby subject to the full panoply of federal regulation under the Federal Power Act. The Commission, under its then-existing authority, was powerless to remedy this problem.

Congress believed that filling this statutory gap was important to enhance the reliability of all power systems.[7] Accordingly, Congress enacted Section 210 of the Power Act for the purpose of giving the Commission new authority in this area. First, Section 210 empowers the Commission to issue an order sua sponte, which it previously could not do except in emergency situations. Second, the statute enables the Commission to require entities not otherwise subject to its jurisdiction (*e.g.*, intrastate utilities and power pools, and municipally-owned utilities) to establish an interconnec-

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[7] As Senator Johnston explained when he introduced the provision that became Section 210 of the Power Act on the floor of the Senate:

> Our amendment provides authority for the Commission to order the physical connection of transmission facilities between electric utilities whether or not those utilities are presently covered by the Federal Power Act. Such an order may be made only when the Commission finds such action necessary to encourage energy conservation or the optimum efficient use of electric utility facilities and resources.
>
> The authority provided in this amendment is not to be used to remake the structure of any utility system. Thus, the reference in this amendment to sales and exchanges of electric energy and coordination among utilities applies only to those interactions and transactions which are necessary to effectuate the interconnection. The amendment states explicitly that no Federal Power Act regulation shall be extended under this amendment to any utility which is not presently covered by the act, except to the limited extent necessary to provide for compliance with an interconnection order.

123 Cong. Rec. 31194 (1977). See *id.* at 32397–32398 (colloquy between Sen. Domenici and Sen. Johnston); *id* at 32398–32399 (colloquy between Sen. Bartlett and Sen. Johnston). See also ***Public Utility Rate Proposals of President Carter's Energy Program: Hearing on S. 122, S. 1300, S. 1363, S. 1364, S. 1469 (Part E) Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources***, 95th Cong., 1st Sess., Pt. 3 (1977).

tion; concomitantly, Congress exempted these entities from any further regulation under the Federal Power Act.[8] Finally, the section "extended the right to apply for interconnection orders" to qualifying cogeneration and small power production facilities, which previously might not have been "engaged in the * * * sale of electric energy" within the meaning of 16 U.S.C. 824a(b). H.R. Conf. Rep. No. 95–1750, 95th Cong., 2d Sess. 90 (1978).

b. This background highlights the court of appeals' misreading of Section 210(e)(3)(B). Section 210(e) of PURPA directs the Commission generally to exempt qualifying facilities from electric utility regulation. Under Section 210(e)(3)(B), the Commission may not exempt qualifying facilities from the Commission's new authority under Section 210 of the Power Act to compel any cogenerator or small power producer (whether qualifying or not) or any entity that sells electricity[9] to interconnect with any electric utility or qualifying facility. As the Commission explained (Pet. App. B–181), its construction of Section 210(e)(3)(B) is consistent with the plain language of the statute. The common definition of "exempt" is "to release or deliver from some liability or requirement to which others are subject." *Webster's Third New International Dictionary* 795

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[8] Section 204(b)(2) of PURPA, 94 Stat 3140 (16 U.S.C. (Supp. IV) 824(b)(2)), amended Section 201(b) of the Federal Power Act, 16 U.S.C. (& Supp. IV) 824(b) by adding the following exclusion:

> The provisions of sections [210] * * * and [212] * * * shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this [Act] with respect to such provisions. Compliance with any order of the Commission under the provisions of section [210] * * * shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

[9] See note 4, *supra*.

(1976). Thus, by stating that no qualifying facility may be "exempted" from the provisions of Section 210 of the Power Act, Congress meant that such facilities may not be excused from the burden imposed by FPA Section 210, *i.e.*, the burden of being subject to the Commission's authority to order an interconnection.

In contrast to this common sense reading of the statute, the court of appeals in effect read Section 210(e)(3)(B) as if it said *utilities* may not be exempted from the *benefits*—the "procedural and substantive * * * safeguards" (Pet. App. B–22)—of Sections 210 and 212 of the Power Act when the Commission implements Section 210(a) of PURPA. By its express terms, however, Section 210(e)(3)(B) does not affect, or even address, the authority granted the Commission under Section 210(a) of PURPA to mandate that electric utilities purchase electricity from and sell electricity to qualifying facilities. Indeed, if Congress had intended to subject the Commission's authority to compel such transactions to the procedural and substantive requirements of Section 210 of the Power Act, Congress surely would have said that *utilities* may not be exempted from Section 210 of the Power Act, not that "no qualifying * * * facility * * * may be exempted * * *." Furthermore, it stands to reason that if Congress had such a result in mind it would have said so in Section 210(a) of PURPA, where obligations are imposed on utilities, not in Section 210(e), which deals only with exemptions of qualifying facilities from regulation.[10]

[10] The court of appeals' erroneous reading of the statute is underscored by examination of Section 210(c) of the Power Act, which requires the Commission, before issuing an interconnection order, to find, *inter alia*, that such an order is in the public interest and will encourage the overall conservation of energy or capital, or optimize the efficiency of use of facilities and resources. 16 U.S.C. (Supp. IV) 824i(c)(1), (2)(A) and (B). Congress could not possibly have meant to require the Commission to make these findings every time a qualifying facility seeks to interconnect with a utility for the purpose of effectuating the

c. To be sure, the statutory scheme is complex. But that complexity should not be seized upon to obscure the plain fact that Congress' overriding purpose in enacting Section 210 of PURPA was to encourage cogeneration and small power production.[11] The decision below would undermine that congressional purpose by requiring a full-scale administrative adjudication before a utility could be compelled to agree to purchase electricity from a qualifying facility.[12] As a result, qualifying facilities would be subjected to the very type of public utility regulation from which Congress sought to insulate them.[13]

purchases and sales required by Section 210 of PURPA, because in enacting the latter statute Congress itself struck the balance in favor of compelling utilities to purchase electricity from any qualifying facility.

[11] Indeed, the very complexity of the statute should have given the court of appeals pause before it substituted its own construction for that of the agency. See *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 87 (1975).

[12] Although the court below suggested that the Commission might adopt "streamlined procedures" (Pet. App. B-23) in handling interconnection applications from qualifying facilities seeking to sell electricity, the term "evidentiary hearing," as used in Section 210 of the Power Act, is defined in 16 U.S.C. (Supp. IV) 796(20) as a proceeding conducted in conformity with the requirements of the Administrative Procedure Act, 5 U.S.C. (& Supp. IV) 554, 556 and 557.

[13] See H.R. Conf. Rep. No. 95-1750, *supra*, at 98:

> The conferees wish to make clear that cogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner. The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.

Furthermore, Congress' program was designed to leave the detailed, case-by-case oversight of these transactions to state authorities. See *FERC* v. *Mississippi*, *supra*. The Commission's rules effectuate this intention by providing that any disputes over the costs of establishing an interconnection under Section 210(a) of PURPA (which costs are determined by the utility but paid by the qualifying facility) are to be resolved by the state commissions. 18 C.F.R. 292.306. Contrary to this legislative scheme, the court's decision would, instead, effectively shift substantial responsibility for resolving disputes under PURPA back to the federal authority.

Since April 1980, more than two hundred entities have filed applications with the Commission for certification as qualifying facilities. If the panel's decision is allowed to stand, each of these entities could conceivably be burdened with years of litigation to establish an interconnection necessary to sell power to a utility. That time-consuming effort will almost certainly discourage all but the very largest cogenerators from participating in what Congress intended to be a major and comprehensive national energy conservation program. Fulfillment of the congressional objective requires reversal of the decision below.

2.a. The court of appeals' decision invalidating the "full avoided cost" rule also warrants review. Although the articulated basis for the court's holding was that the "[Commission] did not justify and explain its decision to adopt the rule" (Pet. App. B–34), underlying that holding is the apparent belief that a full avoided cost rule could *never* be justified because such a rule would be at odds with the requirements of Section 210(b) of PURPA. Thus, the court stated at one point that the Commission's rejection of a rule that would have established rates at less than 100% of avoided costs "seems entirely inconsistent with the clear intent of section

210(b)" (Pet. App. B–12). To be sure, in its opinion denying rehearing, the court explained that it did not declare the Commission's rule inconsistent with the statute (Pet. App. B–203). But the court's hostility to the full avoided cost rule appears to rest, at least in part, on the notion that the Commission lacks authority to adopt such a rule, whatever justifying reasons it might proffer.

The statute, however, expressly authorizes the Commission to adopt a rule based on full avoided cost. Section 210(b) of PURPA states that "[no] rule [establishing a rate for purchase] shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." Incremental costs means full avoided cost (Pet. App. B–8 n.28). At the same time, the Commission was required to establish a rate that was "just and reasonable to the electric consumers of the electric utility and in the public interest * * *." 16 U.S.C. 824a–3(b)(1).[14] While Congress did not set the lower end of the zone of reasonableness, it expressly stated that a full avoided (or incremental) cost rule was within that zone, but at the upper end. See H.R. Conf. Rep. No. 95–1750, *supra*, at 98.

It is settled that "courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'" *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968), quoting

[14] The terms "in the public interest" and "just and reasonable" are interchangeable terms in the ratemaking context. See, *e.g.*, *United Gas Pipe Line Co.* v. *Mobile Gas Service Corporation*, 350 U.S. 332, 345 (1956); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). In both cases this Court concluded that a Commission finding that a rate is so low as to adversely affect the public interest is sufficient to satisfy identical provisions of the National Gas Act and the Federal Power Act requiring a Commission finding that a rate is "unjust" or "unreasonable" before the Commission may fix a new rate.

FPC v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942). The Commission's full avoided cost rule clearly fell within the congressionally established zone of reasonableness. The court of appeals nevertheless set that rule aside, concluding that the Commission failed to justify it. In so concluding, the court below seriously misapprehended the meaning and effect of the rule and the congressional purpose that guided the Commission's rulemaking authority.

b. In the court's view, "[b]ut for the [Commission's] regulations, the utility may have paid a cogenerator a market purchase rate of something less than the full avoided cost, under standard industry practice," and the regulations "requir[e] the payment of full avoided cost to any new cogeneration facility" (Pet. B–13). Contrary to the court of appeals' perception, the Commission's full avoided cost rule does not require that *actual* rates be set at full avoided cost.

First, although Section 210(f) of PURPA requires the states to "implement" the Commission's rules, any state regulatory authority and any nonregulated electric utility may apply to the Commission for a waiver of its rules. Waivers may be granted where a full avoided cost rate is demonstrated to be unnecessary to encourage cogeneration or small power production. 18 C.F.R. 292.403.[15]

In addition, qualifying facilities and utilities may negotiate contract prices that are lower than a full avoided cost rate. 18 C.F.R. 292.301(b). Both the utility and the qualifying facility obtain significant advan-

[15] Moreover, state regulators and nonregulated utilities are permitted to set the rate for purchases below full avoided cost for purchases from facilities whose construction began prior to the effective date of PURPA if they determine that a lower rate is consistent with the statutory standards and is sufficient to encourage cogeneration and small power production. 18 C.F.R. 292.304(b)(3).

tages from a negotiated agreement. Many qualifying facilities must secure a long-term agreement with a utility in order to obtain institutional financing for a project. Because the Commission's rules do not require a utility to sign a long-term contract with a qualifying facility, the utility is in a position to negotiate a price below full avoided cost in return for the longer term commitment. In this way, the qualifying facility, the utility, and the utility's customers all benefit.

At bottom, then, the court below failed to recognize that the very purpose and intended effect of the full avoided cost rule is to avoid the fixing of an unalterable economic relationship. Its aim instead is merely to set the context for bargaining between qualifying facilities and utilities.[16] A full avoided cost rate simply duplicates the context that would exist in a competitive and unregulated market. Indeed, a lower rate undoubtedly would deter some cogeneration and small power production, thereby perpetuating the inefficiencies of traditional power production, to the ultimate detriment of the consumers.

By the same token, the court overlooked the significant long-term economic savings to consumers and to the national interest in reducing dependence on imported oil as a result of the promotion of these new technologies. Increased electric energy production by efficient qualifying facilities will replace more expensive and less efficient oil generation by utilities and help to

[16] Only in the event that a qualifying facility and a utility fail to reach agreement would the state's full avoided cost rate be implicated. As the Court recognized in *FERC* v. *Mississippi*, *supra*, slip op. 16, "the statute and the implementing regulations simply require the [state] authorities to adjudicate disputes arising under the statute." Disputes will arise only if the seller and the purchaser are unable to agree. Moreover, as noted above, in that event the states would be free to petition the Commission for a waiver of the full avoided cost rule.

avoid or defer construction of generating capacity. See *FERC* v. *Mississippi*, *supra*, slip op. 6, 13. Ultimately, this will reduce utility rates and directly benefit consumers and the nation.

c. By directing the Commission on remand to consider a host of "concerns" raised by the full avoided cost rule (Pet. App. B–12 to B–16), the court below has impermissibly sought to substitute its judgment for that of the Commission. Thus, for example, the court stated that the Commission "*should allocate the benefits more evenly* between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not *disproportionately discourage* cogeneration" (Pet. App. B–12; emphasis added). But Congress left it to the Commission, not the courts, to balance these interests. As we have shown, the Commission's full avoided cost rule is the result of a reasonable balancing of these interests. While the court might have preferred a different rule as a matter of policy, the court had no business overruling the Commission's judgment on that ground.

Similarly, the court deemed it "especially necessary" that the Commission on remand "demonstrate the factual basis for its conclusion of 'insignificant' savings for [consumers]'" (Pet. App. B–11). Yet the court did not indicate how the Commission could better support in a rulemaking record any particular percentage of avoided cost other than 100%, or full avoided cost. Presumably, if the Commission selected 75% or 85% of avoided cost, it would be subject to the same sort of challenge that its decision was not factually supported. The fact of the matter is that none of the commenters in the rulemaking proceeding made any effort to demonstrate that any particular percentage figure would be sufficient to

induce the development of cogeneration and small power production. It apparently was understood by all that the full avoided cost rule was adopted as a predictive judgment based on agency expertise regarding the rate level necessary to encourage future cogeneration and small power production, and that factual justification was neither possible nor required. See, *e.g.*, *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 594–595 (1981); *FPC* v. *Transcontinental Gas Pipe Line Co.*, 365 U.S. 1, 28–29 (1961). There is no reason to believe, and indeed it is unlikely, that a subsequent rulemaking would produce a better record in this regard.[17]

Moreover, the court's unwarranted intrusion upon the Commission's decision-making domain appears to be grounded upon application of an erroneous standard of review. This Court has repeatedly stated that rules promulgated after informal rulemaking are subject not to the "substantial evidence" test, but to an "arbitrary and capricious" standard. See, *e.g.*, *FCC* v. *National Citizens Committee for Broadcasting*, 436 U.S. 775, 803 (1978); *FCC* v. *WNCN Listeners Guild*, *supra*, 450 U.S. at 594. Yet, in vacating the full avoided cost rule, the court appears instead to have relied on the rule of *Public Systems* v. *FERC*, 606 F.2d 973 (D.C. Cir. 1979), a case in which the court had applied a "substantial evidence" test on review of an informal rulemaking by the Commission under the Federal Power Act. It is true that the section governing judicial review in that Act (16 U.S.C. 825*l*(b)), "prescribes a 'substantial evi-

[17] It also should be noted that Congress directed the Commission to promulgate its rules under Section 210 of PURPA within a one-year deadline. As the District of Columbia Circuit has itself recognized, "unless we are quite certain of our basis for doing so, we must be slow to overturn the Agency's judgment, whichever way it may incline, when Congress had required it to act quickly and decisively despite the lack of exact data." *Weyerhaeuser Co.* v. *Costle*, 590 F.2d 1011, 1026 (1978).

dence' standard for findings of fact in orders." 606 F.2d at 979. But, as the dissenters from the denial of rehearing en banc recognized (Pet. App. B–207 n.2), because Section 210 of PURPA, pursuant to which the full avoided cost rule was promulgated, did not amend the Federal Power Act, there was no basis for employing the "substantial evidence" standard of review rather than the more lenient arbitrary and capricious standard required by the Administrative Procedure Act, 5 U.S.C. 706(2)(A).

In short, the decision below represents the same type of judicial interference with agency rulemaking procedures that this Court condemned in *Vermont Yankee Nuclear Power Corporation* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 547–548 (1978): "If the agency is compelled to support the rule which it ultimately adopts with the type of record produced only after a full adjudicatory hearing, it simply will have no choice but to conduct a full adjudicatory hearing prior to promulgating every rule."

d. Unless the decision below is overturned, the substantial benefits of increasing the efficient use of energy and reducing the nation's reliance on traditional fossil fuels that Congress sought to achieve in enacting Section 210 of PURPA may never be realized. A majority of the states have complied with the requirements of Section 210 of PURPA by implementing the Commission's full avoided cost rule. If the lower court's decision is permitted to stand, the Commission's full avoided cost rule will be vacated, and the validity of the states' implementing regulations may be jeopardized.

Furthermore, the several years' delay that would result from the initiation of a new rulemaking in a remanded proceeding may cause potential industrial firms to forego the option of building new cogeneration facilities due to the uncertainty of the price that those firms can obtain from sales of cogenerated power. Sources of

funds for project financing of qualifying facilities are likely to diminish since the revenue stream from the output of a qualifying facility is no longer assured. It is also safe to say, if past experience is a reliable guide, that utilities will be unwilling to negotiate contracts with qualifying facilities once the full avoided cost rule—the context for bargaining—is removed.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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